

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 18629
[Redacted] Petitioner.)	
)	DECISION
)	
)	
_____)	

On February 3, 2005, the Tax Discovery Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted](Petitioner) asserting a total Idaho income tax refund in the amount of \$3,438 for the 2003 taxable year. The Petitioner filed a petition for redetermination dated February 21, 2005. The Tax Commission, having reviewed the file, upholds the February 3, 2005, Notice of Deficiency Determination.

ISSUE PROTESTED

Whether a nonresident trust that has both Idaho and non-Idaho source income can deduct all of its tax preparation fees on its Idaho return or whether it must prorate the deduction based on the percentage of Idaho income to total income.

FACTS

[Redacted] is a [Redacted] based Complex Trust and is a shareholder of [Redacted] (S-Corporation). [Redacted] apportioned a percentage of its taxable income to Idaho for the tax years 1997 through 2003. Therefore, [Redacted] pro-rata share of the Idaho apportioned income is Idaho source income to [Redacted]. Because it had not filed Idaho income tax returns, the Tax Discovery Bureau notified [Redacted] of their Idaho filing requirement.

During calendar years 2003 and 2004, [Redacted] filed non-resident fiduciary income tax returns for tax years 1997 through 2002. On April 6, 2004, the [Redacted] paid an estimated tax of \$8,000 for the 2003 tax year. On December 20, 1994, [Redacted] filed its 2003 Idaho non-

resident fiduciary return and directly allocated all of its fiduciary, accounting, and legal fees (\$62,350) to Idaho for the preparation of the 1997 through 2003 returns. The return showed a request for a refund of \$7,990.

ANALYSIS

Under Internal Revenue Code § 641(b), a trust is generally allowed the same deductions for trade or business expenses and expenses for the production of income as an individual. Nonbusiness deductions including interest, taxes, fiduciary fees, charitable contributions, legal fees, tax preparation fees, and miscellaneous deductions must be itemized.

Idaho Code § 63-3026A(1) provides that the Idaho taxable income of a nonresident trust includes only those components of Idaho taxable income derived from or related to sources within Idaho. Idaho taxable income is computed without itemized deductions except as provided for in § 63-3026(A)(4). Thus, according to the statutory language, “sourcing” is applicable only to components of Idaho taxable income other than itemized deductions. Itemized deductions of a nonresident trust must be prorated using a ratio of Idaho taxable income to total taxable income rather than specifically allocated. I.C. § 63-3026(A)(4).

For Idaho purposes, itemized deductions are defined under Internal Revenue Code § 63. Idaho Code § 63-3022(j)(2). Itemized deductions are all deductions allowed in computing adjusted gross income except those subtracted from gross income and except the deductions for personal exemptions. I.R.C. § 63(d).

All ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business are allowed as a deduction under I.R.C. § 162. In order to deduct tax preparation fees as a trade or business expense, a taxpayer must show the portion of the fees attributable to his trade or business. Treas. Reg. 1.62-1T(d). The IRS has ruled that tax

preparation fees allocable to preparing an individual taxpayer's Schedule C for business income and expenses are deductible under I.R.C. 62(a) and do not have to be itemized. Rev. Rul. 92-29. However, legal and accounting fees cannot be deducted as a business expense for limited partners and shareholders. Tech. Adv. Mem. 9728002 (July 11, 1997).

In this case, the [Redacted] is a shareholder in [Redacted] S-Corporation. The trust must report its share of [Redacted] Idaho source income. The trust's share of Idaho source income is determined by applying the allocation and apportionment provisions of Idaho Code § 63-3027 to each pass-through item. I.D.A.P.A. 35.02.01.263. The tax preparation fees paid by the trust are not a pass-through item. Moreover, a shareholder is not considered to be in the trade or business of his corporation simply because he is a shareholder. *Kliethermes v. U.S.*, 27 Fed. Cl. 111, 113, (1992). Because the [Redacted] is an investor in [Redacted] and is not itself engaged in an Idaho trade or business, the expenses of preparing tax returns are deductible only as itemized deductions. A nonresident trust must prorate these deductions as provided by Idaho Code § 63-3026A(4) and may not directly allocate them to Idaho taxable income.

CONCLUSION

WHEREFORE, the Notice of Deficiency Determination dated February 3, 2005, is hereby APPROVED, AFFIRMED, and MADE FINAL.

<u>YEAR</u>	<u>REFUND</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL REFUND</u>
2003	\$(3,438)	\$ 0	\$ 0	\$(3,438)

An explanation of the Petitioner's right to appeal this decision is enclosed with this decision.

DATED this _____ day of _____, 2006.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2006, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]